Before the
Federal Communications Commission
Washington, DC 20554

In the Matter of	)	
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Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming	)	MB Docket No. 07-269
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	)	

To: The Commission

REPLY COMMENTS OF NBC UNIVERSAL, INC.

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To: The Commission

REPLY COMMENTS OF NBC UNIVERSAL, INC.

NBC Universal, Inc. ("NBCU") submits these reply comments in response to the Notice of Inquiry ("*Notice*") and Supplemental Notice of Inquiry ("*Supplemental Notice*") issued by the Federal Communications Commission ("FCC" or "Commission") in the above-captioned proceeding.[1]

I. INTRODUCTION AND SUMMARY

The opening comments in this proceeding document a media marketplace that is fiercely competitive with more programming networks, more multichannel video programming

[1] *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Notice of Inquiry, MB Docket No. 07-269, 24 FCC Rcd 750 (2009) ("*Notice*"); *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Supplemental Notice of Inquiry, MB Docket No. 07-269 (rel. Apr. 9, 2009) ("*Supplemental Notice*").

distributors ("MVPDs") and thus more source, outlet and content diversity than ever before. The Internet as a distributor of high-quality video programming has reached the tipping point, with online video-watching among young adults nearly universal, and the demand for compelling content among all of these outlets is voracious. It is against this background that the call of a small minority of commenters for a return to 1970s-style regulation of programming networks must be measured and soundly rejected.

II. THERE IS NO FACTUAL OR LEGAL BASIS FOR REIMPOSITION OF FIN/SYN RULES OR ANY OTHER PROGRAMMING RESTRICTIONS DRAWN FROM THE THREE-NETWORK ERA

Given the dramatic changes in the media landscape over the last forty years – including the well-established viability of the Internet as a video distribution outlet with limitless capacity, the Commission must reject calls to initiate a proceeding intended to resurrect, or impose obligations similar to, the financial interest and syndication ("Fin/Syn") rules.[2] As the

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[2] The Fin/Syn rules were adopted in 1970 to address the Commission's perception that the (then three) major broadcast networks held excessive market power. *Amendment of Part 73 of the Commission's Rules and Regulations With Respect to Competition and Responsibility in Network Television Broadcasting*, 23 FCC Rcd 382, 400 (1970), *aff'd sub nom. Mt. Mansfield Television v. FCC*, 442 F.2d 470 (2nd Cir. 1971). At that time, the three networks collectively captured 90 percent of the nation's viewing audience each night. James L. Gattuso, et al., *Adjusting the Picture: Media Concentration or Diversity?*, Heritage Foundation Lecture #798, Oct. 7, 2003. The rules prohibited a broadcast network from (i) syndicating programs for rebroadcast by independent television stations; (ii) purchasing syndication rights to programs it obtained from outside producers; or (iii) obtaining any other financial stake in such programs. *See In Re Evaluation of the Syndication and Financial Interest Rules*, 6 FCC Rcd 3094, para. 3 (1991). In 1990, the Commission reviewed the Fin/Syn rules and concluded that the networks still exerted some level of market dominance. *Evaluation of the Syndication and Financial Interest Rules*, 5 FCC Rcd 6463 (1990). The Commission then modified the Fin/Syn rules to require networks to purchase at least 40 percent of primetime programming from independent producers. *Evaluation of the Syndication and Financial Interest Rules*, 5 FCC Rcd 3094, 3095 (1991). This outcome,
(continued on next page)

Commission has recognized on numerous occasions, the three-network television landscape that prompted adoption of the Fin/Syn rules is long gone, and there is no possibility that it will ever re-emerge. Yet the Independent Film & Television Alliance ("IFTA") continues to ask the Commission to turn the regulatory clock back to that bygone era and adopt rules soundly rejected by the courts and the Commission more than 15 years ago.[3]

As a threshold matter, Fin/Syn proposals have no place in comments solicited to assist the Commission in reporting on the status of competition in the retail distribution of programming to consumers; neither the *Notice* nor the *Supplemental Notice* asked for comment on this issue. More importantly, there simply is no factual or legal basis to justify initiation of the requested proceeding. As explained below, the case for Fin/Syn or similar regulation is far weaker today than in 1992, when the rules were vacated as unsupportable by the Seventh Circuit; far weaker than in 1995, when the Commission allowed the last of its Fin/Syn rules to sunset; far weaker than in 2003, when the Commission declined to re-impose greater regulation on the broadcast networks; and far weaker than in the record for the Commission's most recent quadrennial media ownership review, when the networks submitted an economic analysis that thoroughly rebutted IFTA's call in that proceeding for new Fin/Syn rules. Given the myriad and continuously expanding options for distribution and consumption of video programming,

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which had been opposed by the U.S. Department of Justice, ultimately was vacated by the U.S. Court of Appeals for the Seventh Circuit (the "Seventh Circuit"). *Schurz Communications, Inc. v. FCC*, 982 F.2d 1043 (7th Cir. 1992).

[3] *See* Comments of the Independent Film & Television Alliance ("IFTA Comments") at 15 (requesting that the Commission initiate proceedings regarding distribution opportunities for independently supplied programming on television, cable and the Internet).

coupled with the dramatically declining percentage of combined audience share attributable to all broadcast networks, any return to regulation in this area is wholly unwarranted.[4]

A. The Commission Repeatedly and Correctly Has Declined to Re-Impose the Fin/Syn Rules

Nearly twenty years ago, in 1992, the Seventh Circuit found that "the structure of the television industry ha[d] changed profoundly" since adoption of the Fin/Syn rules twenty years before that.[5] Among other reasons given for vacating the rules, Judge Posner explained in writing for the *Schurz* court that "[w]here in 1970 the [original three broadcast] networks had 90

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[4] To the extent IFTA asks the Commission to impose Fin/Syn-type restrictions on cable channels that are owned by companies that, in turn, are ultimately owned by entities that also own broadcast networks, it is highly doubtful that the Commission possesses the legal authority to adopt such regulations. Moreover, IFTA's concern with vertical integration is misplaced and not supported by the facts. As the U.S. Court of Appeals for the District of Columbia Circuit concluded in a decision released today, there has been since 1992 "a dramatic increase both in the number of cable networks and in the programming available to subscribers." *Comcast Corp. v. FCC*, No. 08-1114 at 14 (D.C. Cir. Aug. 28, 2009). The universe of cable networks is enormous and growing, with more than 565 national programming networks identified by the Commission as of mid-2006 in its *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 24 FCC Rcd 542, ¶ 106 (2009). The majority of these networks "are not affiliated with any cable operator, DBS operator, or broadcast media entity," i*d.*, ¶ 187, and many of them contract with independent producers for programming.

Moreover, the video landscape has been transformed since mid-2006 by the explosive growth in online video watching. In July 2009, 158 million Americans – 80 percent of the nation's online population – watched video content online, with Google – a company not connected to any of the major broadcast networks – continuing to rank as the top U.S. online video destination by a very wide margin. According to comScore, this level of online viewing represents an 88 percent increase from July 2008 and the largest online video audience recorded by comScore to date. S*ee http://www.multichannel.com/article/338701-July_Biggest_Month_Yet_For_Online_Video.ph* ("Multichannel News/comScore"). When all the facts in the record are considered, including the huge number of video outlets competing for programming to attract viewers, the suggestion that the Commission should regulate the suppliers of programming to these outlets (or a subset of these outlets) is unsupportable.

[5] *Schurz*, 982 F.2d at 1043.

percent of the prime-time audience, today they have 62 percent, and competition among as well as with the three networks is fierce. They are, moreover, challenged today by a fourth network, the Fox Broadcasting Corporation, which emerged in the late 1980s."[6] Of course, there were no cable networks available to viewers in 1970. Faced with this factual background, the court told the FCC that it could not ignore the decline in market share and market power of the three original networks.

In accordance with the *Schurz* decision, the Commission scaled back the Fin/Syn rules in 1993 and ordered a gradual sunset of the rules by 1995. The Commission ultimately found that the continuing decline in network market share and the emergence of alternate programming options were sufficient to "limit[] a network's ability to control the market or dictate prices for prime time entertainment programming."[7]

In its 2002 review of the media ownership rules, the Commission declined to re-impose any Fin/Syn restrictions, despite the urging of certain commenters that it do so.[8] The Commission noted there that (as here) a proposal to reinstate the Fin/Syn rules was "not squarely within the four corners" of the proceeding and could not "be thought to be a logical outgrowth"

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[6] *Id.* at 1046.

[7] *Evaluation of the Syndication and Financial Interest Rules*, 1993 FCC Lexis 6558, 73 Rad. Reg. 2d 1452, ¶ 34 (1993).

[8] *See 2002 Biennial Regulatory Review—Review of the Commission' s Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996; Cross-Ownership of Broadcast Stations and Newspapers; Rules and Policies Concerning Multiple Ownership of Radio Broadcast Stations in Local Markets; Definition of Radio Markets; Definition of Radio Markets for Areas Not Located in an Arbitron Survey Area*, 18 FCC Rcd 13620, 13865-66 (2003) ("*2002 Quadrennial Review Order*").

of the notice in that case.[9] Moreover, the Commission emphasized that "[w]hen the Seventh Circuit affirmed the Commission's decision repealing all of the fin/syn rules, it questioned whether the rules 'ever had much basis' and cautioned that, if the Commission ever decided to re-impose similar restrictions, 'it had better have an excellent, compelling reason' to do so."[10] In the 2002 Quadrennial Review, no such basis existed for Fin/Syn or similar restrictions.[11] Importantly, the Commission found in the *2002 Quadrennial Review Order* that any reduction in independently produced prime time programming "on a small subset of television networks is not, by itself, a public interest harm. … The record does not demonstrate that consumers and viewers are harmed as a result of network financial interests in the programming they carry, *particularly in light of the quantity and variety of media outlets for programming in today's marketplace*."[12]

Several years ago, IFTA attempted to resurrect the Fin/Syn rules in the context of the Commission's 2006 Quadrennial Review.[13] As support, IFTA offered the same paper written by

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[9] *Id.*

[10] *Id.* at 13869.

[11] *Id.*

[12] *Id.* (emphasis added). The Commission explicitly stated that the record failed to show that "an 'access' rule for independent producers [i.e., source diversity] will advance viewpoint diversity." *Id.*

[13] The Commission did not reach the substance of IFTA's submission, determining instead that issues of source diversity and independently-produced programming were not appropriately considered in a media ownership proceeding. *See 2006 Quadrennial Regulatory Review—Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996; 2002 Biennial Regulatory Review—Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996; Cross-Ownership of Broadcast Stations and*
(continued on next page)

Dr. Mark Cooper, Director of Research at the Consumer Federation of America, that it has attached to its comments in the instant proceeding.[14] In response, NBCU joined with other broadcast networks (the "Network Commenters") in submitting an economic analysis prepared by Dr. Bruce Owen[15] in which Dr. Owen rebutted Dr. Cooper's conclusions. The Network Commenters summarized Dr. Owen's key findings as follows:

> Dr. Cooper's conclusion … makes even less sense now than it did in the 1970 rules struck down by the Seventh Circuit in 1992. … As Dr. Owen explains, there is no valid basis for Dr. Cooper's claims that the networks' economic power or media concentration is greater now than it was in the past. 'Horizontal concentration is measured in a relevant market that makes sense from the point of view of customers (viewers and advertisers). It is inconceivable that concentration today, measured reasonably, could be anything but much less than in the years of fin/syn quotas.' As Dr. Owen notes, there is 'no sound basis [for the Commission] to insert itself into the business decisions of individual distributors, at the risk of raising costs and prices in the market, when neither horizontal concentration nor diversity concerns remotely raise issues requiring such a risk."[16]

The Network Commenters also demonstrated that broadcast television accounted for a combined average 47 percent share of primetime viewing among all television households during the 2004-

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Newspapers; Rules and Policies Concerning Multiple Ownership of Radio Broadcast Stations in Local Markets; Definition of Radio Markets; Ways to Further Section 257 Mandate and To Build on Earlier Studies; Public Interest Obligations of TV Broadcast Licensees, 23 FCC Rcd 2010, 2014, n.17 (2007)

[14] Mark Cooper, *The Impact of the Vertically Integrated, Television-Movie Studio Oligopoly on Source Diversity and Independent Production*, Consumer Federation of America (2006).

[15] Dr. Owen is Morris M. Doyle Centennial Professor in Public Policy and Professor of Economics at Stanford University. His qualifications are well known to the Commission.

[16] Reply Comments of CBS Corporation, Fox Entertainment Group, Inc. and Fox Television Stations, Inc., NBC Universal, Inc. and NBC Telemundo License Co., and The Walt Disney Company, MB Docket No. 06-121 (filed Jan. 16, 2007) ("Network Commenters Ownership Reply Comments") at 7-8 (internal citations omitted). The Network Commenters Ownership Reply Comments, including Dr. Owen's analysis, are attached as Exhibit A.

2005 television season, down 48 percent from the 90 percent share garnered by only three broadcast networks in 1970.[17] As discussed further below, that share has continued to decline. IFTA's proposals then – as now – were procedurally and substantively deficient, as they were beyond the scope of the proceeding and failed to advance any valid purpose.[18]

B. The Video Programming Marketplace Today Provides No Justification for Fin/Syn Rules

The main thrust of IFTA's argument appears to be that an inability to obtain broadcast network distribution of independent programming results in an inability to garner audience share for that programming. The falsity of IFTA's underlying premise is demonstrated by the dramatically shrinking network audience share. As the Network Commenters demonstrated in 2007, network programming then accounted for less than half of the audience share during primetime. That percentage has continued to fall steadily in the last two years, with viewing of all broadcast networks combined[19] dipping to 30 percent in regular-season prime time and to 20 percent in summer-season prime time. Moreover, the tipping point at which basic cable viewing surpassed broadcast network viewing was reached in the 2002-2003 season, and the gap between the two has steadily widened, with cable capturing nearly 60 percent of this summer's viewing, compared to combined network viewing of 20 percent.

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[17] Network Commenters Ownership Reply Comments at 10, citing *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 21 FCC Rcd 2503, ¶ 93 (2006).

[18] Network Commenters Ownership Reply Comments at 2-3.

[19] This includes the four major networks and all emerging English-language networks.

The record is clear – viewers are watching programming on cable, satellite and, increasingly, the Internet. As Commissioner McDowell explained last year in a speech regarding Fin/Syn, "[p]rofound changes have occurred since 1992. Today, the average consumer has a choice of at least three subscription video providers, and sometimes five. Cable companies pass over 92 percent and serve approximately 60 percent of households. DirecTV and Echostar … serve over 30 million consumers and have grown to a 30 percent market share among MVPDs. Now phone companies are in the video business too. … The reach of the broadcast networks has fallen far below the 62 percent of the prime-time audience cited by the court in 1992. During the current season, the combination of 77 ad-supported cable networks posted higher ratings among the key 18 to 49 demographic than the broadcast networks …. In 1992, there was no public Internet, let alone Internet video."

Indeed, the availability of video on the Internet is a critical component of today's media marketplace that was unimaginable when Judge Posner was writing for the *Schurz* court in 1992. A recent Pew study indicates that more than a third of Internet users (35 percent) now say they have viewed a television show or movie online, nearly doubling from 16 percent just since 2007. Among young adults, online video-watching is nearly universal – 89 percent of Internet users between 18-29 watch content on video sharing sites, and 61 percent regularly watch TV shows and movies online. Even among older Americans, online video watching has become mainstream – among Internet users ages 50-64, 41 percent watch video online, and 27 percent of wired seniors ages 65 and older access video content online. Based on these statistics, the Pew study concludes that online video is "pervasive" and that 2009 marks "an important moment in the evolution of America's television and movie viewing habits."[20] Nevertheless, for purposes of its audience share argument, IFTA ignores or significantly downplays the growth of Internet video, as well as non-broadcast programming available via cable and satellite. Given the incredible transformation in the video programming marketplace in the nearly two decades since *Schurz*, IFTA's calls to revisit the Fin/Syn regime defy all fact and logic.

1. Online Availability of Network Programming Has No Impact on the Ability of Independent Programmers to Reach Internet Audiences

While IFTA ignores the availability of video programming online as one of many distribution alternatives to broadcast channels, it simultaneously bemoans the creation of "go to" or "destination" websites focused on network television programming.[21] Specifically, IFTA asserts that without government-mandated access to broadcast networks, independent video programming "is automatically shut out of the Internet distribution opportunities that may follow."[22] This argument does not withstand scrutiny for two reasons: websites associated with established networks feature independently produced programming, and the largest distributor of online video has no connection to any of these networks.

Sites such as nbc.com offer viewers an opportunity to watch program episodes they may have missed on television, as well as the convenience of an alternative distribution vehicle for

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[20] Mary Madden, *The Audience for Online Video-Sharing Sites Shoots Up*, Pew Internet & American Life Project, July 2009, http://www.pewinternet.org/Reports/2009/13--The-Audience-for-Online-VideoSharing-Sites-Shoots-Up.aspx.

[21] IFTA Comments at 3, 10.

[22] *Id.* at 12 ("If independent video programming is shut out of network television, then it is automatically shut out of the Internet distribution opportunities that may follow for network aired programming.").

network programming. Hulu.com, in which NBC is a partner, obtains video content from a variety of sources and offers an easy-to-use and appealing user interface. Both sites thus respond to growing consumer demand for video programming where, when and how they want to view it. But sites associated with established broadcast networks don't succeed by limiting their content to in-house productions. As IFTA acknowledges, one-third of the feature films offered on hulu.com are independently produced, including by IFTA members.[23] Independently produced television programs are also prominently featured on hulu.com. Indeed, one of the most popular programs on the NBC Network <u>and</u> on Hulu – *America's Got Talent* – comes from an independent production company.

IFTA also ignores the fact that the largest distributor of independently produced online video content – by orders of magnitude – is a company, Google, that has no connection at all to the established broadcast networks. Of the 21.4 billion videos watched by 158 million viewers in July 2009, 42 percent – 8.9 <u>billion</u> – were watched on a Google-owned website, as compared to 457 million on Hulu.[24]

Moreover, the relative success of sites such as hulu.com and nbc.com in no way limits the ability of independent programmers to find an online home for their products. The unique feature of the Internet as a media outlet is its limitless capacity. Therefore, IFTA's members face absolutely no regulatory or other barriers impeding them from creating their own "go to" websites offering high-quality programming and appealing user interfaces. The key to success –

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[23] *Id.*

[24] *See Multichannel News/comScore, supra* n.4. Viacom Digital ranked a distant second, with only 3.8 percent of online videos viewed in July, while hulu.com ranked fifth. *Id.*

and the challenge that all programmers face – is offering content that consumers want to watch – whether on broadcast networks, cable networks or the Internet.[25]

2. Popular Content, Not Increased Regulation of Broadcast Networks, Will Stimulate Broadband Uptake

To the extent the Commission is concerned with the role of video programming in stimulating increased demand for broadband services,[26] the path to that goal is clear – websites that offer lawful access to popular programming will be a key driver. Moreover, that process is already well underway, with the popularity of websites such as YouTube.com and hulu.com driving consumers to subscribe to broadband services. The initiative by cable operators to allow their subscribers, upon verification, to view programming online is another trend that will stimulate demand for broadband. In each case, the quality and popularity of the programming – not the identity or affiliation of the producer –fuel the desire for broadband access. The notion that increased regulation of broadcast networks and unwarranted governmental intrusion into programming decisions, rather than offering a product that consumers want, will somehow move the broadband uptake needle is simply wrong.

[25] As the Commission explained in the 2002 Quadrennial Review Order, there is no basis to conclude that independently-produced programming necessarily is superior to network programming: "It is up to consumers and viewers to determine what programming they want to watch, and networks, as they compete for viewers, must be responsive to those demands. It is not for this agency to intervene in the decisions that determine the content of programming (absent obscenity or indecency concerns)." *2002 Quadrennial Review Order*, 18 FCC Rcd at 13869.

[26] *See* IFTA Comments at 10.

III. CONCLUSION

The original Fin/Syn rules were denounced by academic experts from the outset, by the Commission's staff in the late 1970s, by the Commission itself as early as the 1980s, by the Seventh Circuit in 1992 and, finally and definitively, by the Commission more than a decade ago. Given the dramatic and fully documented changes in the video programming marketplace in the last ten years, there is no conceivable justification for initiating a proceeding to consider re-imposing such regulations. Now that watching video programming on the Internet has entered the mainstream, the demand for quality online programming will increase, as will the demand for ubiquitous broadband availability. It is the latter challenge – universal broadband – on which the Commission's efforts should be focused, not on resurrecting outmoded regulatory schemes that have been repudiated by the courts and the Commission itself.

Respectfully submitted,

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August 28, 2009

EXHIBIT A

NETWORK COMMENTERS OWNERSHIP REPLY COMMENTS (2007)

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
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2006 Quadrennial Regulatory Review – Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996	)	MB Docket No. 06-121
	)	
2002 Biennial Regulatory Review – Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996	)	MB Docket No. 02-277
	)	
Cross-Ownership of Broadcast Stations and Newspapers	)	MM Docket No. 01-235
	)	
Rules and Policies Concerning Multiple Ownership of Radio Broadcast Stations in Local Markets	)	MM Docket No. 01-317
	)	
Definition of Radio Markets	)	MM Docket No. 00-244

REPLY COMMENTS OF CBS CORPORATION, FOX ENTERTAINMENT GROUP, INC. AND FOX TELEVISION STATIONS, INC., NBC UNIVERSAL, INC. AND NBC TELEMUNDO LICENSE CO., AND THE WALT DISNEY COMPANY

January 16, 2007

SUMMARY

In these joint reply comments, the Network Commenters urge the Commission to reject the calls of a few commenters for resurrection of the long-discredited Fin/Syn rules and imposition of programming set-asides, essentially quotas to protect so-called "independent" producers from competition. The Fin/Syn Proponents ask for a set-aside of time on the major broadcast networks for independent production, ignoring the judicial and Commission precedent that eviscerated any justification for government interference in the market for the distribution of video programming. These proposals are beyond the scope of the *Notice of Proposed Rulemaking* issued for this quadrennial review and, therefore, should be summarily dismissed. Furthermore, all of the Fin/Syn Proposals are premised on the notion of regulated "source diversity." In the *2002 Biennial Review Order*, however, the Commission found that government regulation was not necessary to promote source diversity because of the dramatic changes in the television market, including the significant increase in the number of channels available to most households.

As Dr. Bruce Owen demonstrates in his accompanying economic statement, the Fin/Syn Proposals make even less sense now than they did when the original regulations were struck down by the Court of Appeals in 1992. No matter how measured, the Fin/Syn Proponents cannot credibly claim that the economic power of the four leading broadcast television networks or media concentration is greater now than in the past. There is no sound basis for the federal government to reinsert itself into the business decisions of the networks, at the risk of raising costs and prices in the market, when neither horizontal concentration nor diversity concerns raise issues requiring such a risk. The case presented by the Fin/Syn Proponents falls far short of the compelling justification that the Commission would need to

revive its Fin/Syn (including program quota) requirements, and these proposals again should be rejected.

The FCC also lacks the authority to modify the UHF discount as part of this proceeding. Contrary to the claims of some commenters, the Appropriations Act, as interpreted by the Third Circuit, precludes such a review. The Commission should reconsider the rule, if at all, after the digital transition is complete. Only then can the FCC make an accurate assessment of the market and determine the degree to which legacy UHF stations continue to suffer disadvantages compared with their legacy VHF competitors. As part of any such review, the Commission also should rescind its earlier proposal sunsetting the discount for stations that are both owned and affiliated with one of the major networks, a decision reached before the Appropriations Act required it to lower the national ownership cap.

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REPLY COMMENTS OF CBS CORPORATION, FOX ENTERTAINMENT GROUP, INC. AND FOX TELEVISION STATIONS, INC., NBC UNIVERSAL, INC. AND NBC TELEMUNDO LICENSE CO., AND THE WALT DISNEY COMPANY

CBS Corporation ("CBS"), Fox Entertainment Group, Inc. and Fox Television Stations, Inc. ("FOX"), NBC Universal, Inc. and NBC Telemundo License Co. ("NBC"), and The Walt Disney Company ("ABC") (collectively the "Network Commenters") hereby submit their reply to the comments filed in response to the Federal Communications Commission's ("FCC" or "Commission") *Further Notice of Proposed Rulemaking*,[1] released in July 2006, initiating a

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[1] *See In re 2006 Quadrennial Regulatory Review – Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996*, Further Notice of Proposed Rulemaking, 21 FCC Rcd 8834 (2006) ("*Notice*").

comprehensive review of the media ownership rules in accordance with the requirements of Section 202(h) of the Telecommunications Act of 1996.[2]

I. THE ATTEMPTS BY COMMENTERS TO REVIVE THE PREVIOUSLY REJECTED FIN/SYN PROPOSALS ARE OUTSIDE THE SCOPE OF THIS PROCEEDING, INADEQUATELY SUPPORTED AND SHOULD BE DISMISSED

Ignoring judicial and Commission precedent that has eviscerated any justification for government-mandated source diversity, several parties ask the Commission to resurrect, in some form, its prior financial interest/syndication ("Fin/Syn") rules and to impose programming set-asides, essentially quotas to protect so-called "independent" producers from competition.[3] For example, the Independent Film & Television Alliance ("IFTA") proposes that networks "be limited to supplying 75% of their own programming . . . ."[4] The Screen Actors Guild, the Directors Guild of America, the Producers Guild of America, and the American Federation of Television and Radio Artists, AFL-CIO (collectively, the "Entertainment Guilds") propose a similar 25 percent independent producer rule for the major broadcast networks' primetime programming.[5] The Fin/Syn Proposals should be dismissed as both procedurally and

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2 Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, § 202(h) (1996) ("1996 Act").

3 Consistent with the Commission's *2002 Biennial Review Order*, the Network Commenters refer to these various requests for some government mandated set-aside of network time or quota for independent production as the "Fin/Syn Proposals," and those advancing them as the "Fin/Syn Proponents." *See In re 2002 Biennial Regulatory Review*, Report and Order and Notice of Proposed Rulemaking, 18 FCC Rcd 13620, ¶ 640 (2003) ("*2002 Biennial Review Order*").

4 Independent Film & Television Alliance Comments, at iii. "In essence, IFTA requests that the Commission limit the amount of self-sourced programming that the major television networks may distribute on their primary networks, or on secondary or tertiary digital multicast channels. We also suggest these limits apply to cable program services owned, controlled by, or affiliated with either the major networks or the largest cable MSOs and DBS satellite system operators." *Id.* at ii-iii.

5 Entertainment Guilds Comments, at 24.

The Caucus for Television Producers, Writers & Directors ("TV Caucus") proposed a similar scheme: "We urge the FCC to adopt rules that: require 25% of all television programs be independently produced and owned by an independent source . . . ." TV Caucus Comments, at 1.

substantively deficient since they are beyond the scope of the Commission's *Notice* and fail to advance any valid purpose.

The Commission concluded that nearly identical proposals submitted in the 2002 biennial review were not responsive to the Notice of Proposed Rulemaking in that proceeding.[6] Likewise, the proposals submitted in the current proceeding are beyond the scope of the *Notice* for this quadrennial review and should be dismissed.[7] Not only do the Fin/Syn Proposals not belong in this proceeding, there is also no valid justification to revive these outdated policies.

The Fin/Syn Proposals are all premised on the notion of regulated "source diversity," which refers to the availability of media content from a variety of producers.[8] However, the era that spawned the rules, when television was dominated by three broadcast networks, passed long ago. Therefore, when considering many of the same Fin/Syn Proposals as part of the 2002 biennial review, the Commission concluded that source diversity should not be an objective of its ownership policies.[9] "In light of dramatic changes in the television market, including the significant increase in the number of channels available to most households today, we find no basis in the record to conclude that government regulation is necessary to promote source

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6 *See 2002 Biennial Review Order*, 18 FCC Rcd at ¶ 642.

7 *See, e.g., In re Amendment of Parts 73 and 74 of the Commission's Rules to Establish Rules for Digital Low Power Television*, 19 FCC Rcd 19331 (2004) ("We will not consider the . . . proposal because the issue was not addressed in the *Notice* and is therefore beyond the scope of this proceeding.").

8 *See 2002 Biennial Review Order*, 18 FCC Rcd at ¶ 42. The Commission's past efforts to regulate source diversity also focused on its Prime Time Access Rule ("PTAR"), which was eliminated when the Commission could not justify it in light of media marketplace changes. *See id.* (citing *Schurz Communications, Inc. v. FCC*, 982 F.2d 1043 (7th Cir. 1992) (remanding the Commission's decision to retain modified Fin/Syn rules, including independent programming set-aside requirements); *In re Review of the Syndication and Financial Interest Rules*, 10 FCC Rcd 12165 (1995) (eliminating the Fin/Syn rules)).

9 *See 2002 Biennial Review Order*, 18 FCC Rcd at ¶ 43.

diversity."[10] Since the current Fin/Syn Proponents fail to provide evidence to support renewed government regulation of source diversity, their proposals should also be rejected as part of this review.

Moreover, these ill-considered efforts to revive some form of the Fin/Syn rules are destined for failure since they cannot possibly survive judicial scrutiny. A brief review of the history of the Commission's Fin/Syn restrictions and an examination of the current program production market convincingly demonstrate that revival of any type of Fin/Syn requirement would be counterproductive and legally unsustainable.

The Commission originally adopted the rules in 1970 to curb what it perceived as the "excessive" power of the major broadcast networks.[11] In 1970, there were three broadcast networks collectively capturing some 90 percent of the nation's viewing audience each night;[12] cable was in its infancy; and direct broadcast satellite ("DBS"), and fiber-based video systems did not exist. Today, consumers can use these delivery systems to access as many as 530 different programming channels.[13] In addition, new technological developments like personal digital devices and the Internet provide potentially unlimited sources of video content. The Commission's rules, later replicated and enforced through consent decrees between the networks and the U.S. Department of Justice ("DOJ"), were based on the FCC's belief that the networks

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10 *Id.* at ¶ 44.

11 The rules specifically prohibited a broadcast network from (i) syndicating programs for rebroadcast by independent televisions stations, (ii) purchasing syndication rights to programs it obtained from outside producers, or (iii) obtaining any other financial stake in such programs. *See In re Evaluation of the Syndication and Financial Interest Rules,* Report and Order, 6 FCC Rcd 3094, ¶ 3 (1991) ("*1991 Report and Order*").

12 James L. Gattuso, et al., *Adjusting the Picture: Media Concentration or Diversity?*, Heritage Foundation Lecture #798, Oct. 7, 2003.

13 *See In re Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Twelfth Annual Report, 21 FCC Rcd 2503, ¶ 21 (2006) ("*Twelfth Annual Video Competition Report*").

would attempt to control the programming market to eliminate and forestall any future competition on the distribution side.[14] Seeking to strengthen independently-owned stations vis-à-vis the networks, the Commission mistakenly believed that the rules would protect these stations against having to purchase syndication rights from the networks.

The Commission first began a comprehensive review of its Fin/Syn rules in 1990 in response to a petition by FOX.[15] While acknowledging that dramatic changes had occurred in the television industry in the intervening 20 years, the Commission nonetheless concluded that the networks still exerted some level of market domination necessitating retention of modified Fin/Syn rules. The Commission also imposed an entirely new regulation with no counterpart in the original Fin/Syn rules, requiring the broadcast networks to purchase at least 40 percent of their primetime programming from independent producers. The 40 percent quota differed from a condition contained in the DOJ's consent decrees that required the networks to limit the hours of network-owned programming aired during the primetime schedule. The DOJ not only *supported elimination* of the FCC's Fin/Syn requirements in its comments during the Commission's review, it specifically objected to the 40 percent set-aside.[16]

The U.S. Court of Appeals for the Seventh Circuit vacated the Commission's revised Fin/Syn regulations on appeal, holding that the FCC had wholly failed to justify the rules in light of dramatic changes in the television marketplace. Writing for the court, Judge Posner observed that "profound" change had taken place in the industry and noted that the networks had "lost ground" in the preceding 15 years as a result of the "rapid growth" of the cable television

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[14] *See Schurz Communications, Inc. v. FCC*, 982 F.2d 1043, 1046 (7th Cir. 1992).

[15] *See 1991 Report and Order*, 6 FCC Rcd 3094.

[16] The Department of Justice's consent decrees were completely lifted by 1993.

industry.[17] Given these marketplace developments, the court questioned the justification and wisdom of further restraining the networks' competitive ability through the continuation and augmentation of the Fin/Syn and quota requirements.[18] The court's analysis also labeled as "never very clear" the Commission's original reasoning in adopting the Fin/Syn rules: that the broadcast networks would somehow leverage their distribution "monopoly" into the production market.[19] Indeed, the court in *Schurz* determined that "contrary to the intention behind the rules, yet an expectable result of them because they made television production a riskier business," the production of primetime programming under the Fin/Syn rules had become *more* concentrated.[20]

In 1993, the Commission greatly scaled back most of its Fin/Syn restrictions in response to the *Schurz* decision and also ordered the gradual sunset of the few remaining restraints, which occurred without fanfare in 1995.[21] The FCC recognized that the decline in network market share had continued unabated even between 1991 and 1993 due to the emergence of alternate programming options, including the burgeoning cable industry. Agreeing with the conclusion of the *Schurz* court, the Commission determined that these competitive alternatives served to "limit[] a network's ability to control the market or dictate prices for prime time entertainment programs."[22] Citing Judge Posner's analysis, the Commission concluded that the rules had

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17 *Schurz*, 982 F.2d at 1046, 1053.

18 *Id.*

19 *Id.* at 1046.

20 *Id*.

21 *See In re Evaluation of the Syndication and Financial Interest Rules, Second Report and Order,* 8 FCC Rcd 3282 (1993) ("*1993 Report and Order*"). The *1993 Report and Order* immediately removed the restrictions on network acquisition of financial interests and syndication rights in network primetime programming and the 40 percent cap on network in-house productions. Other restrictions were phased out more gradually. *See id.* at ¶ 12.

22 *Id*. at ¶ 45.

proven ineffective as the production community had actually become increasingly concentrated under the Fin/Syn regime.[23] In other words, far from aiding small independent producers, the rules favored those companies with pockets deep enough to withstand the high risks of producing entertainment programming for primetime network television. Thus, the Commission eliminated the Fin/Syn restrictions, finding that financial involvement by the networks would increase the chances "that this type of small producer can obtain financing."[24]

Notwithstanding the unfortunate results of past government interference in the program production market, the Fin/Syn Proponents again urge the Commission to require networks to reserve a percentage of their schedule for independently-produced primetime television programming. The Fin/Syn Proponents would also limit a network's financial interest in a program and preclude a network from controlling domestic syndication rights.[25]

In support of the its extraordinary request for a government mandated 25 percent set-aside for independent production, IFTA submitted with its comments a paper written by Dr. Mark Cooper, Director of Research at the Consumer Federation of America. However, as Dr. Bruce Owen, Morris M. Doyle Centennial Professor in Public Policy and Professor of Economics at Stanford University, demonstrates in his economic analysis attached hereto, Dr. Cooper's conclusion that "restricting competition in the manner proposed by IFTA will increase 'source diversity' . . . makes even less sense now than it did in the 1970 rules struck down by the Seventh Circuit in 1992."[26] Furthermore, given the Commission's determination in the *2002*

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23 *Id.* at ¶¶ 17, 53.

24 *Id.* at ¶ 51.

25 *See* Entertainment Guilds Comments, at 25.

26 Comments of Bruce M. Owen, at 2, attached hereto as Exhibit A.

Biennial Review Order that source diversity should not be a policy goal of its broadcast ownership rules, and the fact that the *Notice* fails even to mention source diversity, Dr. Owen correctly questions why Dr. Cooper now endorses government regulation to increase source diversity.[27]

As Dr. Owen explains, there is no valid basis for Dr. Cooper's claims that the networks' economic power or media concentration is greater now than it was in the past.[28] "Horizontal concentration is measured in a relevant market that makes sense from the point of view of customers (viewers and advertisers). It is inconceivable that concentration today, measured reasonably, could be anything but much less than in the years of fin/syn quotas."[29] As Dr. Owen notes, there is "no sound basis [for the Commission] to insert itself into the business decisions of individual distributors, at the risk of raising costs and prices in the market, when neither horizontal concentration nor diversity concerns remotely raise issues requiring such a risk."[30]

The Entertainment Guilds present an equally dubious case. They claim that independently produced programming aired on the primetime schedule for the Big 4 networks (ABC, CBS, FOX and NBC) has declined from 66 percent in 1992 to 24 percent today.[31] In fact, the Entertainment Guilds paint a picture of the program production market that bears no relationship to reality. Examination of the data on which the Entertainment Guilds rely demonstrates that they greatly understate the current role of independent production companies in primetime programming. For example, the Entertainment Guilds' calculations (contained in

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[27] *Id.* at 3.

[28] *Id.* at 3-4.

[29] *Id.* at 4.

[30] *Id.* at 6.

[31] *See Entertainment Guilds Comments*, at 18, Attach. C.

Attachment C to their comments) exclude from the "independent producer" category those programs provided by studios affiliated with another network. These programs clearly should be counted as independently produced programs since the producer is entirely independent of the exhibiting network. Moreover, the Entertainment Guilds include news and sports programming in its computations, which makes no sense since there is no syndication market for these programs. And surely the Commission would not adopt a rule that penalizes networks for presenting informational programming in primetime. In any event, when shows produced by studios affiliated with another network and news/sports programs are excluded, the level of network-owned programming, based on the Entertainment Guilds' data, drops from 76 percent to 51 percent for the 2006-2007 season.

More importantly, the Entertainment Guilds treat as network-owned any program which is co-owned with an independent producer.[32] This too unfairly skews the data; there is no valid basis to discount independent producers merely because they work collaboratively with a network. To the contrary, repeal of the Fin/Syn rules has opened the door to a variety of independent companies that never could have afforded to participate in the program production market alone. Precisely as the *Schurz* court and the Commission predicted, elimination of the rules has made available to independent companies the capital resources of the networks, enabling them to break into the primetime schedule. When co-productions are excluded, along with news/sports, the networks produced only 35 percent of programming for the 2006-2007 primetime season. Furthermore, to the extent that there has been a drop in independent production on *broadcast* television, the Commission has already made clear: "the reduction in

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[32] *See id.* at Attach. C (defining Networks or Affiliated Producer as "[n]etwork ownership or ownership by production company affiliated with ABC, CBS, Fox, [or] NBC for broadcast on its respective network").

independently produced prime time programming on a small subset of television networks is not, by itself, a public interest harm. Our concern is to promote the interests of consumers and viewers, not to protect the financial interests of independent producers."[33]

As these calculations prove, the *Schurz* court and Commission correctly predicted that market forces are far more effective in promoting program diversity than government regulation. Through cost sharing agreements with networks, independent producers are better able to undertake the enormous risk attendant to production of high-quality programs. The Entertainment Guilds' suggestion that non-network financing for independents will magically appear to fill the gap if a 25 percent set-aside is imposed defies both logic and the painful history of the rules.[34]

The Fin/Syn Proponents also ignore the acceleration of market trends that the *Schurz* court identified in 1992 and the Commission acknowledged in 1993. Broadcast television accounted for a combined average 47 share of primetime viewing among all television households during the 2004-2005 television season,[35] down a whopping 48 percent from the 90 percent share garnered by only three broadcast networks in 1970. Further, as the Network Commenters have demonstrated throughout the Commission's ongoing review of its broadcast ownership rules, with the continued growth of cable, DBS, video by telephone companies, the Internet and other video providers, the broadcast networks now face even greater competition from an array of programming alternatives. In fact, cable and other MVPDs already provide

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[33] *2002 Biennial Review Order*, 18 FCC Rcd at ¶ 651.

[34] *See* Entertainment Guilds Comments, at 26.

[35] *See Twelfth Annual Video Competition Report*, 21 FCC Rcd at ¶ 93 .

hundreds of programming services,[36] eroding the networks' share of the viewing audience.[37] In addition, the Fin/Syn Proponents ignore broadcast networks like the CW, MyNetwork TV and Ion. These networks, as well as cable networks, have profoundly changed the programming marketplace. Clearly, the so-called "Big 4" networks no longer remain the only viable option for primetime programming, and there is no need for intrusive regulation of their programming schedule.

As the Commission stated in the *2002 Biennial Review Order*: "When the Seventh Circuit affirmed the Commission's decision repealing all of the fin/syn rules, it questioned whether the rules 'ever had much basis' and cautioned that, if the Commission ever decided to re-impose similar restrictions, 'it had better have an excellent, a compelling reason' to do so. None appears on this record. Accordingly, we reject the Fin/Syn Proposals."[38] The Fin/Syn Proponents present an even weaker case today for these ill-conceived rules, and these proposals should again be dismissed.

II. THE FCC LACKS AUTHORITY TO MODIFY THE UHF DISCOUNT IN THIS PROCEEDING, AND THE COMMISSION SHOULD RECONSIDER THE RULE, IF AT ALL, ONLY AFTER THE DIGITAL TRANSITION

A. Congress Has Insulated the National Television Ownership Cap – and with It the UHF Discount – from the Quadrennial Review

Notwithstanding the clear import of the Consolidated Appropriations Act of 2004 ("Appropriations Act") as interpreted by the Third Circuit, Prometheus Radio Project

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36 *Id.* at ¶ 21 (noting that there were 531 satellite-delivered national programming networks in 2005).

37 *See, e.g., id.* at ¶ 93 ("As we reported last year, broadcast television stations' audience shares have continued to fall as cable and DBS penetration, the number of cable channels, and the number of nonbroadcast networks continue to grow.").

38 *2002 Biennial Review Order*, 18 FCC Rcd. at ¶ 656 (quoting *Capital Cities/ABC, Inc. v. FCC*, 29 F.3d 309, 316 (7th Cir. 1994)).

("Prometheus") suggests that the Commission has the authority to consider in this docket whether to eliminate or modify the UHF discount pursuant to its general authority under the Communications Act of 1934.[39] Prometheus' position is fatally undermined by the clear language of the statute.

In Section 629 of the Appropriations Act, Congress amended Section 202(c) of the 1996 Act and directed the Commission to modify the national television ownership rule by setting the cap at 39 percent.[40] Congress, however, did not alter in any way the definition of the term "national audience reach," choosing instead to affirmatively ratify the definition, and with it, the 50 percent UHF discount itself.

The national television ownership rule provides that:

> *National audience reach* means the total number of television households in the Nielsen Designated Market Area (DMA) markets in which the relevant stations are located divided by the total national television households as measured by DMA data at the time of a grant, transfer, or assignment of a license. *For purposes of making this calculation, UHF television stations shall be attributed with 50 percent of the television households in their DMA market.*[41]

When the Commission first established a national television audience reach cap in 1984, "no mention was made of treating UHF stations any differently than VHF stations . . . ."[42] In response to several petitions for reconsideration, however, and in recognition of UHF stations' inherent technological and competitive disadvantages, the Commission created the UHF

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39 Prometheus Radio Project Comments, at 2.

40 Consolidated Appropriations Act, 2004, Pub. L. No. 108-199, § 629, 118 Stat. 3 (2004) (the "Appropriations Act") (emphasis supplied).

41 47 C.F.R. § 73.3555(e)(2) (emphasis supplied).

42 *In re Broadcast Television National Ownership Rules; Review of the Commission's Regulations Governing Television Broadcasting; Television Satellite Stations Review of Policy and Rules*, Notice of Proposed Rulemaking, 11 FCC Rcd 19949, ¶ 6 (1996).

discount.[43] Accordingly, the discount has been an integral aspect of the administratively defined term "national audience reach" for 20 years.

The Appropriations Act is not the first time that Congress endorsed the definition of "national audience reach" together with the UHF discount. When Congress required the Commission to revise its national television ownership rule in 1996, it directed the FCC to "increas[e] the *national audience reach* limitation for television stations to 35 percent."[44] The text of the statute was silent as to the UHF discount, but legislative history makes clear that Congress not only adopted the FCC's national television ownership rule, but also that Congress affirmatively desired to retain the UHF discount encompassed in the rule:

> [The 1996 Act] does not change the methodology for calculating 'national audience reach' currently employed by the Commission. For example, currently the audience reach of UHF stations is discounted. This 'UHF discount' appropriately reflects the technical and economic handicaps applicable to UHF facilities and the Committee *does not envision that the UHF discount calculation will be modified so as to impede the objectives of this section*.[45]

The Commission implemented the 1996 Act faithfully to Congress' directive. When it revised the national ownership rule shortly after passage of the 1996 Act, the FCC noted that the law "is silent with respect to the UHF discount . . . which [is] incorporated in the definition of 'national audience reach'" set forth in Section 73.3555 of the Commission's rules.[46] Consequently, the FCC said that the UHF discount, "as set forth in our current rules, will

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[43] *See id.*

[44] 1996 Act, § 202(c)(1)(B) (emphasis supplied).

[45] H.R. Rep. No. 104-204, at 118 (1995) (emphasis supplied).

[46] *In re Implementation of Sections 202(c)(1) and 202(e) of the Telecommunications Act of 1996 (National Broadcast Television Ownership Rule and Dual Network Operations) 47 C.F.R. Sections 73.658(g) and 73.3555*, 11 FCC Rcd 12374, ¶ 4 (1996).

continue to apply."[47] In the Appropriations Act, Congress again used the defined term in directing the FCC to increase the "national audience reach limitation . . . ."[48]

The repeated use by Congress of a term that has had a clear administrative definition for 20 years plainly signifies its intent to adopt the administrative definition. Under longstanding principles of statutory construction, "Congress' repetition of a well-established term generally implies that Congress intends the term to be construed in accordance with pre-existing regulatory interpretations."[49] As the Third Circuit found in *Prometheus*, "when Congress uses an administratively defined term, it intends its words to have the defined meaning."[50] Thus, modifying the UHF discount effectively would undermine the congressional goal of establishing the national cap at 39 percent.[51]

Moreover, as noted above, the Appropriations Act amended the 1996 Act by replacing the Commission's biennial media ownership review obligation with a mandate for quadrennial

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47 *Id.*

48 Appropriations Act, at § 629. In amending Section 202(h) of the 1996 Act to provide for quadrennial rather than biennial reviews of the media ownership rules, the Appropriations Act yet again embraced the term "national audience reach." *See id.* (the new quadrennial review provision "does not apply to any rules relating to the 39 percent national audience reach limitation . . . .").

49 *Toyota Motor Mfg., Kentucky, Inc. v. Williams*, 534 U.S. 184, 193-94 (2002); *see also Bragdon v. Abbott*, 524 U.S. 624, 645 (1998) ("When administrative and judicial interpretations have settled the meaning of an existing statutory provision, repetition of the same language in a new statute indicates, as a general matter, the intent to incorporate its administrative and judicial interpretations as well.").

50 *Prometheus Radio Project v. FCC*, 373 F.3d 372, 396 (3d Cir. 2004).

51 The legislative history of the Appropriations Act bolsters the conclusion that Congress did not intend to alter the UHF discount. Members of both the House and the Senate acknowledged in floor debate that Section 629 was not designed to force any licensee to divest stations as a result of the new level of the ownership cap. Several legislators noted that Congress had considered setting the ownership cap at 35 percent, which would have compelled divestitures in some cases. In contrast, they noted, the "practical effect" of Section 629 was to avoid compelling divestitures – a result that would have been impossible without retention of the UHF discount. *See, e.g.*, 150 Cong. Rec. S129 (daily ed. January 22, 2004) (statement of Sen. Feinstein); 150 Cong. Rec. S129 (daily ed. January 22, 2004) (statement of Sen. Leahy); 150 Cong. Rec. S66 (2004) (daily ed. January 21, 2004) (statement of Sen. McCain); 149 Cong. Rec. H12315 (2004) (daily ed. November 25, 2003) (statement of Rep. Obey).

reviews.[52] In doing so, Congress explicitly said that the new quadrennial review provision "does not apply to any rules relating to the" national TV ownership cap.[53] Accordingly, contrary to Prometheus' contention, the Commission is expressly barred by statute from considering any changes to the UHF discount – indisputably a rule relating to the national cap – as part of this proceeding.[54]

B. So Long as the National Television Ownership Cap Remains in Place, Retention of the UHF Discount Is Essential to the Preservation of UHF Broadcast Stations

The Commission should recognize that because UHF stations continue to suffer technological and financial limitations that are not faced by their VHF competitors, the UHF discount is essential to the viability of UHF stations. Prometheus' argument that "[t]here is no longer any meaningful disparity between the reach of UHF and VHF television stations,"[55] is simply not supported by the facts. VHF stations today continue to have greater coverage and audience reach than UHF stations.[56]

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52 *See* Appropriations Act, at § 629.

53 *Id.* (emphasis supplied).

54 *See also Prometheus*, 373 F.3d at 397. Because the "UHF discount is a rule 'relating to' the national audience limitation," the court said that "the UHF discount is insulated from this and future periodic review requirements." *Id.* Thus, the Commission is precluded from considering the UHF discount as part of any proceeding conducted pursuant to Section 202(h) of the 1996 Act.

While the Appropriations Act prohibits the Commission from considering the UHF discount as part of this or any other quadrennial review proceeding, it does not bar the FCC from ever reconsidering the national cap or the UHF discount, as suggested by Univision. The language of the Appropriations Act makes clear that the FCC's authority is limited only within the context of a Section 202(h) periodic review. Nothing in the Act indicates that the FCC is barred from initiating an examination of its rules in another context.

55 Prometheus Comments, at 7.

56 *See Ex Parte* Letter from John C. Quale to Marlene Dortch, Secretary, FCC, dated May 20, 2003 (filed in MB Docket No. 02-277), Attachments A-C, VHF-UHF Grade B Signal Contour Comparisons. The exhibits demonstrate that the CBS, FOX and NBC/Telemundo owned and operated UHF stations suffer from the very same technological deficiencies that the Commission found in 1998.

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The Commission recognized in 2000 that weaker signals made it difficult for UHF stations to reach over-the-air viewers.[57] The FCC also acknowledged that cable television did not adequately ameliorate UHF stations' technological infirmities.[58] These conclusions remain equally relevant today. Nothing has changed with regard to UHF stations' technological disadvantages. And even though subscribership to MVPDs may have increased since 1998, this does not alter the fact that the signals of many UHF stations continue to fail to reach cable headends.[59]

The challenges are not limited to coverage, however. UHF stations are also more expensive to operate, particularly due to their higher power requirements, and remain less attractive to advertisers. Furthermore, because the digital television technical rules are designed to ensure that DTV stations replicate the signals of their analog counterparts, the completion of the digital transition will not eradicate the historic problems facing former analog UHF stations. Until the transition is complete, it is impossible to know how well UHF digital stations will compare with legacy analog VHF stations, many of which post-transition will operate on UHF channels. And while certain legacy UHF stations may be able to take advantage of the

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Specifically, as the networks demonstrated in 2003, (1) The average NBC/Telemundo-owned UHF station provides a Grade B signal reaching only 56 percent of the service area of the average same-market NBC/Telemundo-owned VHF station; (2) The average CBS-owned UHF station provides a Grade B signal reaching only 57 percent of the service area of the average same-market CBS-owned VHF station; and (3) The average FOX-owned UHF station provides a Grade B signal reaching only 61 percent of the service area of the average same-market FOX-owned VHF station. *Id.*

57 *See In re 1998 Biennial Regulatory Review – Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996*, Biennial Review Report, 15 FCC Rcd 11058, ¶ 35 (2000) (the "*1998 Biennial Review Report*").

58 *See id.*

59 In addition, cable systems have successfully petitioned the Commission to reduce the market of many UHF stations for purposes of must carry based upon lack of signal coverage. *See, e.g., In re Christian Faith Broadcast, Inc. v. Cablevision of Ohio; Request for Mandatory Carriage of Television Station, WGGN-TV Sandusky, Ohio,* Memorandum Opinion and Order, 15 FCC Rcd 9513 (2000).

Commission's rules permitting maximization of facilities, it is likely that there will continue to be a class of stations that suffers from inferior coverage and signal characteristics.[60]

For all of these reasons, consideration of the status of the UHF discount at the very least should be postponed until the conclusion of the digital transition.[61] And when and if the Commission does take up the UHF discount, it also should rescind its earlier proposal for a phased-in elimination of the discount, including a sunset of the discount for UHF stations affiliated with and owned by the top-four broadcast networks, because the Appropriations Act fundamentally altered the assumptions underlying that decision.[62]

Since the Appropriations Act modified the FCC's decision to increase the audience reach cap for the national television ownership rule, reducing it from 45 percent to 39 percent, the Commission must reconsider the sunset of the discount in the context of the new 39 percent ownership cap, or a cap at any other level, for that matter. When it decided to set the ownership cap at 45 percent, the FCC was aware that – even with a sunset of the UHF discount – none of

60 *See* Letter from Paxson Communications Corporation to Marlene H. Dortch, MB Docket No. 02-277, at Attach. 1 (filed May 16, 2003) ("Although the FCC properly has noted that UHF broadcasters' ability to maximize their service area could be an equalizer between UHF and VHF stations, its decision to base the initial DTV Table of Allotments on a principle of replication of service has locked in the signal-coverage disparities of the analog world".).

In its opening comments, the Network Affiliated Stations Alliance ("NASA") expressed concern that the major networks may attempt to increase their station holdings by claiming the UHF discount for legacy VHF stations that wind up operating in the UHF band post transition. *See* NASA Comments, at 2-3. To clarify, the Network Commenters ask only that the Commission account for the challenges that *all* legacy UHF stations (regardless of ownership) will continue to face after the transition. Furthermore, legacy VHF stations should be attributed their full audience reach post transition regardless of their ownership or network affiliation.

61 *See* Entravision Comments, at 21 ("At this time, Entravision submits that the Commission should defer any further consideration of the UHF discount, including sunsetting the discount for the networks, until the completion of the digital transition.").

Capitol Broadcasting Company's request for an immediate review of the UHF discount should be delayed until the digital transition is complete because only then can the Commission adequately assess the market. *See Capitol Broadcasting Company, Inc.* Comments, at 6-7.

62 *See 2002 Biennial Review Order*, 18 FCC Rcd at ¶ 591.

the four affected networks would be required to divest any broadcast stations.[63] In contrast, with an ownership cap set at 39 percent as called for in the Appropriations Act, the elimination of the UHF discount would compel at least two of the networks to divest stations. Requiring the networks to divest stations abruptly would not only harm television viewers (by stripping stations from owners that have historically provided exemplary service – especially with respect to local news), it also would produce a result directly at odds with the goal of avoiding forced divestitures that the Commission expressed in its prior decision.

The FCC clearly lacks the authority to modify any aspect of the national ownership cap, including the UHF discount, as part of this proceeding. However, if the national ownership cap remains in place after the completion of the digital transition, the Commission should reassess the market at that time and take appropriate account of the continuing inferiority that will likely plague legacy UHF stations.

III. CONCLUSION

In sum, as the Commission reviews it broadcast ownership rules, it should take account of the robust and competitive media marketplace of 2006, which offers a panoply of diverse voices. And when it does, the Commission will recognize that it should reject the Fin/Syn Proposals as both procedurally and substantively deficient since they are beyond the scope of the *Notice* and fail to advance any valid purpose. In light of the dramatic changes in the television market, including the significant increase in the number of channels available to most consumers, a regulation premised on government imposed source diversity cannot stand.

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[63] The Commission expressly noted that one of its goals in revising the level of the ownership cap was to "accommodate all existing broadcast combinations . . . ." *2002 Biennial Review Order*, 18 FCC Rcd at ¶ 583.

The FCC also lacks the authority to address the UHF discount in this proceeding, and should reconsider the rule, if at all, after the digital transition is complete. It is only then that the FCC would be able to accurately assess the market and determine the degree to which legacy UHF stations continue to suffer disadvantages compared with their legacy VHF competitors. If and when the Commission does take up the UHF discount, it should rescind its earlier proposal sunsetting the discount for stations that are both owned and affiliated with one of the major networks, a decision reached before the Appropriations Act required it to lower the national ownership cap.

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Dated: January 16, 2007

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PROTECTING INEFFICIENT PRODUCERS HARMS CONSUMERS:

PRELIMINARY COMMENTS ON IFTA'S PROPOSAL AND DR. MARK COOPER'S SUPPORTING PAPER

by

Bruce M. Owen*

When sellers face more efficient competitors, there is always a temptation to call on the power of government to restrict or restrain the competition. Few groups of sellers seeking protection from competition have been as persistent, in the face of repeated rejection, as "independent" Hollywood entertainment producers. They and others purporting to represent their interests were largely responsible for promoting the now discredited Financial Interest and Syndication ("finsyn") Rules.[1] Those rules (and the similarly-spirited Prime Time Access Rule) restricted broadcast network vertical integration into ownership rights to prime time entertainment series. The old rules were adopted by the Commission early in the 1970s and finally repealed in the mid-1990s. The chief policy rationale for their adoption was that the rules would promote source diversity, and the chief policy rationale for repeal was that the rules had no demonstrated relationship to source diversity.

> [The FCC] never drew the link between the rules, which on their face impede the production of television programs--not only by constraining negotiations between networks and outside producers but also by reducing the networks' incentive to produce by limiting the extent to which a network can exhibit its own programs in prime time--and the interest in diverse programming. The Commission may have thought the link obvious, but it is not. The rules appear to handicap the networks and by handicapping them to retard new entry into production; how all this promotes programming diversity is mysterious, and was left unexplained in the Commission's opinion. SCHURZ COMMUNICATIONS, INC. V. F.C.C. 982 F.2d 1043 (7th Cir. 1992) at 1055.

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[1] 47 C.F.R. § 73.6586) (1990); see *Network Television Broadcasting,* 23 F.C.C.2d 382, 387 (1970) aff'd sub nom. *Mt. Mansfield Television, Inc. FCC* 442 F.2d 470 (2d Cir. 1971).

Remarkably, the same discredited arguments and objectives are being trotted out again. A group styling itself The Independent Film & Television Alliance (IFTA) has asked the Commission to set aside a quota of entertainment content, which "independent" producers would have the exclusive right to supply to the broadcast networks.[2] A similar proposal was made and rejected in the 2002 proceeding.[3] The logic is that if the networks are restricted in producing their own content they will be forced to buy from the independents, or to buy at higher prices. True enough. The economic benefit to independent producers from such an arrangement is obvious. But is there benefit for anyone else? In particular, are there benefits for the consumers presumably represented by the Consumer Federation of America?

To address the benefits from restricting competition, the IFTA has attached this time a 75-page paper by Mark Cooper, research director of the Consumers Federation of America.[4] Dr. Cooper concludes that restricting competition in the manner proposed by IFTA will increase "source diversity." Given "dramatic changes in the television market,"[5] this claim makes even less sense now than it did in the 1970 rules struck down by the Seventh Circuit in 1992.

While Dr. Cooper does not himself define source diversity, the Commission went to some trouble to lay out clear definitions and evaluations of the various definitions of diversity in its 2003 *Order*:

> 42. "Source diversity" refers to the availability of media content from a variety of content producers. The *Notice* explained that source diversity can contribute to our "retail" goals of viewpoint diversity and program diversity. Past Commission

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[2] "IFTA defines 'independent' producers and distributors as those companies and individuals apart from the major studios that assume the majority (more than 50%) of the financial risk for production of a film or television program and control its exploitation in the majority of the world." IFTA Comments at n. 1. "IFTA's membership includes such well-known independent film companies as LIONSGATE, The Weinstein Company, and Lakeshore International." Id at 2.

[3] *Report and Order and Notice of Proposed Rulemaking*, 18 F.C.C.R. 13,620 (2003) at ¶ 43.

[4] "The Impact of the Vertically Integrated, Television-Movie Studio Oligopoly on Source Diversity and Independent Production."

[5] *Report and Order and Notice of Proposed Rulemaking*, 18 F.C.C.R. 13,620 (2003) at ¶ 44.

> efforts to regulate source diversity centered on broadcast television. The Prime Time Access Rule (PTAR) and the Financial Interest and Syndication (Fin-Syn) rules limited vertical integration between program producers and broadcast television networks. The Commission eliminated those regulations when it could not justify them in light of media marketplace changes.

And the Commission concluded that there was no need to use ownership regulation to increase source diversity:

> 43. The record before us does not support a conclusion that source diversity should be an objective of our broadcast ownership policies. …
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> 44. When prime time television viewing was dominated by three broadcast networks, the Commission elected to require broadcast networks to purchase prime time programming from unaffiliated producers in order to encourage diversity on television. In light of dramatic changes in the television market, including the significant increase in the number of channels available to most households today, we find no basis in the record to conclude that government regulation is necessary to promote source diversity.
>
> 45. …. Given the explosion of programming channels now available in the vast majority of homes today, and in the absence of evidence to the contrary, we cannot conclude that source diversity should be a policy goal of our broadcast ownership rules.

The September 2006 *Further Notice* initiating this proceeding does not mention source diversity. It is very difficult to understand why Dr. Cooper thinks the Commission, or anyone else, should now endorse government regulation to increase source diversity.

Dr. Cooper also forays into economics, alleging evidence of network economic power and concentration in the entertainment services he considers, and quoting lengthy passages from dated economics texts which warn of the possible dangers from vertical integration. Little of this makes sense. However Dr. Cooper may conceive or measure economic power or media concentration, he can hardly claim credibly that it is greater now than it was in the past. Yet it was in the past, before new media competition had reduced horizontal concentration in national video distribution, that regulatory restrictions on broadcast network vertical integration were rejected. The finsyn rules were denounced by academic experts from the outset (Crandall 1971), by the Commission's staff in the late 1970s (Network Inquiry Special Staff), by the Commission itself as early as the 1980s (until political intervention by President Reagan forced a temporary about face[6]), by the Seventh Circuit in 1992, and finally and definitively by the Commission more than a decade ago.

Ultimately, Dr. Cooper seeks to reinitiate the vertical integration debate as if nothing had happened since the time of the 1970 rules. But the framework against which the need for any rules must be judged has not remained stagnant. The Commission has long had a coherent and rational set of tools for addressing economic policy issues, including related diversity concerns.[7] The major lesson these tools offer for ownership policy is that *horizontal* concentration, not vertical integration, must be the focus of any debate on ownership restrictions. Horizontal concentration is measured in a relevant market that makes sense from the point of view of customers (viewers and advertisers). It is inconceivable that concentration today, measured reasonably, could be anything but much less than in the years of fin/syn quotas.

More important, much of communication policy has been turned upside down since the 1960s. In those years suppression of competition was a common FCC policy. Competition with "the" telephone company was heretical. Cable television was not free to compete until the 1970s. Domestic communications satellites had not yet been freed to fly, and the first direct broadcast satellites lay twenty years in the future. ABC was then recently and barely an effective competitor to CBS and NBC. The World Wide Web and broadband to the home were unknown. Despite the "dramatic changes in the television market," Dr. Cooper would apply the same policies to network programming production as those favored by the 1960s FCC Office of Network Study.

The history of economic and antitrust analysis of broadcast network integration into program production, which is a matter of (voluminous) record beginning in the 1930s, is, overall, one of progress; progress in freeing the forces of market competition to serve

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[6] Matthew McAllister, "The Financial Interest and Syndication Rules," http://www.museum.tv/archives/etv/F/htmlF/financialint/financialint.htm (Museum of Broadcast Communications), (visited 12/10/2006).

[7] Network Inquiry Special Staff, *New Television Networks: Entry, Jurisdiction, Ownership and Regulation, Final Report*, (October 1980).

consumers, and progress in understanding sound economic analysis. I attach a list of some of the major post-1970 analytical critiques of Commission regulations restricting network vertical integration, rather than repeat all this history.

Entertainment distributors, whether at the local or national level, and whether they deal directly or indirectly with the viewer, must compete to attract audiences to sell to advertisers and/or for subscriber revenues. Video distributors compete not only with each other, but also with the many media by which consumers obtain information and entertainment and advertisers acquire access to audiences. Key to success and even to survival in this competition is the ability to identify programming (or more generally "content") that will be attractive to audiences. Equally important is the ability to acquire such programming at the lowest possible cost.

Whether to make or to buy content is a central problem faced by managers in nearly all businesses. Indeed, the make-or-buy decision is central to the very concept of a business firm. Its analysis has a long history in economics, dating at least to Adam Smith. In modern times, the issue is commonly framed in terms of the relative efficacy of a hierarchical organization versus contractual market exchanges in creating worker and supplier incentives compatible with the objectives of the enterprise.[8]

As horizontal media concentration continues to decrease, and competition for audiences and advertisers to increase, it is not surprising that increased vertical integration would be among the strategies considered and used by broadcast networks competing for survival. Whether this is so or not requires a far more sophisticated analysis than Dr. Cooper has put on offer.

A decade ago the completely discredited fin/syn quotas were finally repealed. The framing of the present revival of the issue most useful to the Commission's work is to ask whether there is any more reason to suspect a market failure with respect to the broadcast networks' choice of business organization now than there was decade ago. What has

[8] The classic works are Coase, "The Nature of the Firm," ECONOMICA, 4(n.s.), 1937, 386-405 and Williamson, MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS. 1975.

chiefly changed in the interim is that the market has become less concentrated. Viewers and advertisers have more choices, not fewer, and the shares of the broadcast networks have declined, not increased.

This reality leaves the Commission with no sound basis to insert itself into the business decisions of individual distributors, at the risk of raising costs and prices in the market, when neither horizontal concentration nor diversity concerns remotely raise issues requiring such a risk. Making broadcasters and like media less efficient will only hasten the replacement of traditional content with new media content. Reduced economic efficiency, coming at the ultimate expense of consumers, is too high a price to pay, simply to benefit members of IFTA.

Attachment

Partial Listing of Analyses Critical of Limitations Imposed by FCC Financial Interest and Syndication Rules

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